Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

COMMENTS
of
SANDWICH ISLES COMMUNICATIONS, INC.

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TABLE OF CONTENTS

SUMMARY

Sandwich Isles Communications, Inc. was formed to provide modern telecommunications to the Hawaiian Home Lands because of the refusal of the only large carrier then serving the state to invest in facilities needed to serve remote, low density areas. The Hawaiian Home Lands are insular, rural, high cost areas in the State of Hawaii. Sandwich Isles Communications' success in making basic and advanced telecommunications services available to the 70 parcels of Hawaiian Homelands spread over six islands is and will continue to be inextricably linked to Universal Service Support. It is vital that Universal Service Support continue to work in tandem with the programs of the Rural Utilities Service. Because of the concurrent changes being considered in Intercarrier Compensation, it is important that any changes in Universal Service Support not create severe and unpredictable dislocations that would ultimately be incompatible with changes in access rules. At the end of the day, what is needed is a comprehensive and integrated system of affordable consumer rates, Intercarrier Compensation, and Universal Service Support that will promote investment in rural infrastructure.

Sandwich Isles Communications recommends that Universal Service Support should continue separate mechanisms for rural telephone companies, that the Communications Act definition of rural telephone company should continue to be used, and that support should be determined on a study area basis. Because use of state-wide averages is not appropriate for rural telephone companies, most of which have characteristics far from the averages driven by large carriers, it is most logical to retain use of study area costs. Because support should continue to be based upon costs, differences in cost between small and large rural telephone companies should be reflected in their cost submissions.

A central focus of the Joint Board's inquiry is whether cost should be defined as embedded, forward looking, or some other criteria, and whether models can or should be used to determine cost. The problems that the Rural Task Force found with application of the FCC's forward looking cost model have not disappeared and are even more pronounced in Hawaii where rural area conditions are unique in several respects. Thus even if forward looking cost is adopted, a rural telephone company should always have the ability to determine such cost based upon an individual study of its operating area. Nevertheless, embedded cost remains the more logical method of determining cost for rate of return regulated carriers, such as Sandwich Isles because it avoids the problems of potential radical shifts in support and allows precise determination of the use of support as required by Section 254(e) of the Communications Act.

Finally, Sandwich Isles urges the Joint Board to recommend revision of the FCC's rules governing transferred exchanges. The present rule harms subscribers and delays the deployment of advanced services into rural areas. The Safety Valve provisions do not offer any material relief because of the preclusion of first year investment from the base and the limits on support availability. The history of the spread of telephone service into rural areas since the expiration of the Bell patents in the 19th century demonstrates that small companies best achieve universal service goals. If there is a national objective of moving up from being 11th in the world in broadband deployment, the FCC's rules should encourage, not discourage transfer of ownership to rural telephone companies.

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Sandwich Isles Communications, Inc. ("SIC") responds to the Joint Board's August 16, 2004 Public Notice, FCC 04J-2, requesting comments on issues related to replacement of the high-cost universal service support mechanisms adopted following the *Rural Task Force Order*.

I INTRODUCTION:

A. Interest Of SIC: Fulfillment of the Universal Communications Service Promise to all Americans, including Hawaiians

SIC is a native Hawaiian owned rural telephone company established in 1995 to provide modern telecommunications services to the Hawaiian Home Lands ("HHL") The HHL consist of approximately 70 non-contiguous parcels on the 6 major Hawaiian Islands and administered by the State of Hawaii, Department of Hawaiian Homelands ("DHHL"). Shortly after the introduction of telephone service in the 1880's, a single local exchange carrier emerged as the only provider of service in Hawaii. One hundred years later, when GTE was the sole local telephone company in Hawaii, it was apparent that the promise of Universal Service would not be realized as HHL were developed because GTE's capital contribution requirements made service unaffordable.1 In order to overcome this barrier, SIC was organized and issued a license by DHHL in 1995 to build and operate a modern telecommunications network connecting all of the HHL parcels.

As a result of the combination of Rural Utilities Service capital funding, a reliable interstate revenue stream made possible through participation in the NECA access tariffs and pools, and Universal Service Support, SIC has been able to extend service to over 1200 access lines in 20 new communities, and expects to expand service to an additional 14 communities during 2005. SIC is constructing a fiber network to connect its service areas on the 6 islands, which will permit the delivery of broadband and other advanced services to all HHL areas. Successful completion and operation of SIC's local distribution facilities and its inter-island fiber network is a critical component of the development of the remote HHL areas. "Specific, predictable and sufficient" Universal Service Support for the areas in the HHL is essential to SIC's ability to fulfill its mandate to contribute importantly to achieving the long delayed vision

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1 This refusal of large carriers to commit capital to rural areas throughout the United States was first apparent at the beginning of the 20th Century, and eventually led in mid-century to the telecommunications loan programs now administered by the Rural Utilities Service.

of the 1934 Communications Act and the 1920 Hawaiian Homes Commission Act ("HHCA").[2]

Today, more than 80 years after passage of that Act, HHL communities are finally poised to benefit from distance learning opportunities, telemedicine healthcare, and other quality of life improvements contemplated by the Act and made possible via a broadband network. This network also provides a platform for economic development, allowing Hawaiians to move forward with all other Americans that have or shortly will have access to broadband connectivity. SIC, as the Eligible Telecommunications Carrier in an area that is at once rural, insular, and high cost therefore urges the Joint Board to recognize that proper resolution of this proceeding is absolutely critical to completing a course that was set by Congressional mandate so long ago for the HHL.

Continued sufficient support is important not only to quality of life and economic development of the HHL areas served by SIC, but also to the safety of its residents in remote areas. Beyond the interest of SIC's subscribers, the strategic position of Hawaii during a time of global warfare with an indeterminate enemy makes it important for national security that the nation's remote areas have adequate communications available.

B. The Universal Service Rules should work in tandem with the RUS programs to ensure accomplishment of Congress' Objectives

In the course of developing recommended changes to Universal Service Support

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[2] 42 Stat. 108. The HHCA was incorporated into the Hawaiian Constitution by the Hawaii Statehood Act. 73 Stat. 4.

mechanism, the Joint Board should consider both the objectives and requirements of the Communications Act and all other relevant sources of national policy. Where more than one government program addresses the same issue, it is necessary for the responsible agencies to ensure that the respective programs work harmoniously to achieve common goals. Most prominent of these other manifestations of Congressional intent are the telecommunications programs administered by the Department of Agriculture's Rural Utilities Service ("RUS"). The objectives of the RUS financial programs are to facilitate the widest possible deployment of telecommunications services in rural areas, including POTS, broadband and wireless.[3]

The RUS loan programs operate under strict requirements that the Administrator approve only those loans for projects that can be certified by the Administrator as financially feasible. That certification necessarily involves an evaluation of the projected revenue streams of the borrower over the life of the loan, and Universal Service Support is a very material component of the revenue streams of rural telephone companies, such as SIC. Currently there are more than $4 Billion in outstanding loans, all secured by first mortgages in favor of the U.S. government. Serious disruptions of the interstate revenue streams, access and USF, could result in significant foreclosures with the result of putting the government directly in the business of providing telephone service in rural areas.

The FCC has recently recognized the importance of coordinating its policies with that of

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3 7 U.S.C. 922

RUS in its decision to permit the granting of security interests in spectrum allocations to RUS by licensees.4

C. The Joint Board Should Avoid Substantial Changes With Unpredictable Effects While the Entire Issue of Intercarrier Compensation Remains Open.

Whether Universal Service Support is "sufficient" to enable subscribers to receive supported service cannot be determined in isolation, but can be answered only in the context of what other revenue streams provide cost recovery to rural telephone companies. In order to maintain charges to subscribers at levels that are reasonably comparable to those paid by urban subscribers, revenues from charges to interconnecting carriers must be sufficient to recover costs not recovered by subscriber charges or universal service support. As a result of the failure of access charge regulation to keep pace with dramatic changes in the telecommunications market, there are, unfortunately serious problems with access charge implementation which result in regulatory arbitrage, unequal charges to comparable and often competing services, and loss of revenues to rural telephone companies.

Rather than addressing these problems one by one, many parties suggest just eliminating access charges altogether. In April, 2001 the FCC opened what it described as a "a broad ranging proceeding to explore ways of reforming intercarrier compensation rules." The Commission

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4 *Facilitating the Provision of Spectrum-Based Services to Rural Areas and Promoting Opportunities for Rural Telephone Companies to Provide Spectrum-Based Services,* Report and Order and Further Notice of Proposed Rule Making, WT Doc. No. 02-381, FCC 04-166, Sep. 7, 2004.

asked for comment on two staff papers which proposed variations on the concept of "bill and keep" in which carriers recover their costs of originating and terminating traffic from their own customers.[5] Rural telephone companies and their associations objected that such bill and keep plans would increase the cost of telephone service in rural areas to levels which would be unaffordable for a significant portion of their subscribers. Recently, at least three separate proposals for addressing intercarrier compensation have been presented to the FCC and it is expected that the Commission will issue a new NPRM shortly.[6]

The intercarrier compensation issues, indicated above, are inextricably interwoven with the proper structure and level of the universal service support mechanisms. At least some of the proposals being considered by the Commission would dramatically increase the levels of support required to maintain reasonable comparability between urban and rural rates. The existence of this second, and potentially more comprehensive proceeding necessarily indicates that it would be unwise to make major structural revisions to the current USF mechanisms whose unpredictable results would complicate and delay the overall intercarrier proceeding.

The intercarrier proceeding is also relevant to the Joint Board's recommendation because of the need for rural telephone companies in general, and those serving remote insular areas in particular, to have reasonable rate comparability with urban areas for both wholesale and retail

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5 *Developing a Unified Intercarrier Compensation Regime,* Notice of Proposed Rule Making, 16 FCC Rcd 9610 (2001)

6 Letter from Gary M. Epstein to Marlene H. Dortch, Secretary, October 5, 2004, CC Doc.

rates. The structure of the industry requires that most carriers at some point utilize the facilities of others. Prior to the 1996 Act, the FCC recognized the importance of maintaining the access rates of rural telephone companies at levels reasonably comparable to urban companies. When it removed the mandatory participation requirement from the NECA pools, the FCC required LECs exiting the pool to continue contribution at a level sufficient to maintain the pool rate at a national average level. 7 With passage of the 1996 Act and the requirement that all carriers contribute to universal service support, the FCC maintained the mechanism.8 With the possibility of further radical shifts from access to universal service support, the Joint Board should recognize that the need for comparability of wholesale rates remains, especially for carriers such as SIC with substantial transport costs.

II THE UNIVERSAL SERVICE SUPPORT MECHANISMS SHOULD CONTINUE TO DEFINE RURAL TELEPHONE COMPANY FOR USF PURPOSES BY THE COMMUNICATIONS ACT DEFINITIONS AND BASE SUPPORT ON STUDY AREA COST

A. Continue Use of Statutory Definition

The Public Notice asks whether the statutory definition of rural telephone company should continue to be used to identify rural carriers for purpose of determining high cost support, or should some finer distinctions be created, such as small, medium and

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No. 01-292

7 *MTS and WATS Market Structure,* Report and Order, 2 FCC Rcd 2953, 2957-58 (1987)

8 *Federal-State Joint Board on Universal Service,* CC Doc. No. 96-45, Report and Order, 12 FCC Rcd 8776, 8942 (1997) ("*First Report and Order")*

large?9 While changes in this definition are not likely to affect SIC directly (because even at full build-out it will remain a small company by industry standards), SIC suggests the Joint Board retain the current definitions for a number of reasons.

First, while it is true that there are very substantial size differences between companies that meet the statutory definition, as long as support is based upon costs, a system which properly captures the effects of any economies of scale will necessarily adjust the amount of support provided. Second, the Joint Board has raised questions as to so many of the variables in the current formula it will be very difficult to predict the effects of any particular change in the rules. Since the critical difference between companies should remain the use of company (however defined) rather than state wide costs and the use of individual studies rather than the synthesis model, it makes most sense to resolve the core issue, the measurement of cost, before asking for evaluations of the alternative definitions of rural. Once the core issue is decided, and either the current system retained or a new cost measurement methodology adopted, the Joint Board can then ask for analysis of impact of changing definitions.

B. Continue Use of Study Area by Rural Telephone Companies

All cost determinations involve some allocations that are unavoidably arbitrary. Further, as a practical matter some degree of averaging of costs and prices will always be required. For

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9 Public Notice, paras 9, 11

most small rural companies, including SIC, the study area and the company are synonymous, so that there are no consequences from using a larger corporate unit. Going in the other direction, determining costs on the basis of subdivisions of a study area, such as wire centers would not only increase the cost of cost studies, but would necessarily involve increase in importance of arbitrary allocations of joint and common cost.

Further, once the ”portability rule” is removed and the support eligibility of competitive ETCs is based on their own cost, there will be no real need for more granularity beyond the study area level for rural companies. Until the portability rule is removed, rural companies have the option under the disaggregation rules to incur the expense of determining costs on a more granular level, but there is no reason to inflict that cost on all rural companies.

III WHETHER EMBEDDED OR FORWARD LOOKING COST IS USED, EACH CARRIER'S SUPPORT SHOULD BE DETERMINED BY REFERENCE TO ITS PARTICULAR FACTS AND CIRCUMSTANCES

A. SIC's Hawaiian Service Area, and other Insular Areas, are Particularly Unsuited for Cost Determination by a Model

In Section 254 Congress gave the FCC and the Joint Board specific principles and objectives, and specifically recognized the particular needs of America's insular areas to be included in the support mechanisms to be developed. This specific inclusion is a result of the unique geographical challenges of insular areas, their remoteness from the mainland, the difficulty in installing and maintaining facilities, and the constant threat of tropical storms, all of which make the availability of adequate communications imperative.

Although the Commission initially determined that all USF support should eventually be based on forward looking cost, it was subsequently convinced by the Rural Task Force and the Joint Board that the synthesis model could not accurately predict the forward looking costs of rural telephone companies.[10] The Commission therefore decided to continue the use of embedded cost to determine the support for rural telephone companies for a five-year period, which ends in 2006. The Public Notice raises several questions regarding whether the cost basis for support to rural telephone companies should be based on forward looking or embedded cost, and how such costs should be determined.[11]

Sandwich Isles is a relatively new telephone company with much of its build out ahead of it. It has, and will continue to construct its facilities using the most efficient technology available, as it is required to do to obtain RUS funding. Because its facilities costs are recent and ongoing, Sandwich Isles' embedded and forward looking costs can be expected to be quite comparable. Whether support based on forward-looking cost would be "specific, sufficient and predictable" will depend upon how accurately its costs are measured, how accurately the cost of other companies with which it is compared is measured, and how the support formulas to which costs are applied are constructed. Without answers to these questions, the issue of whether a support system based on forward looking costs will meet the Acts goals cannot be determined.

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10 *Federal-State Joint Board on Universal Service,* 14th Report and Order, 22d Order on Reconsideration, 16 FCC Rcd 11244, 11256 (2001).

11 Public Notice, paras 20-25.

The Rural Task Force report demonstrated conclusively that the Commission's synthesis model does not accurately predict the forward looking costs of rural telephone companies. Because of the Sandwich Isles unique service territory, scattered areas over six volcanic islands separated by deep ocean and remote from the mainland, the chances of the model being accurate are even more remote.12 Adjustment to the model inputs to account for SIC's circumstances is unlikely to produce accurate results, short of constructing an entirely new model with only SIC specific inputs.13 At that point it makes more sense to simply perform an individual forward looking cost study. Therefore, if forward looking costs are to be used, for SIC or most other rural telephone companies, they should be determined based on a company specific study.

B. The Use of Embedded Costs to Determine Support Is More Logical for Rate of Return Carriers and more consistent with Section 254(e)

Assuming guidelines can be adopted which would result in reasonably consistent answers for studies of the same area by different people, the next question will be how to construct the support formula. The current rules in Parts 32, 36, 54 and 64 operate together to develop

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12 In the *First Report and Order* the Commission recognized that insular areas often have lower subscribership rates that the rest of the country, and stated it would issue a Public Notice seeking comment on how to address the concern. 12 FCC Rcd at 8997. SIC is not aware that the Public Notice has ever been issued.

13 In any case, no model can be validated by testing inputs, only where outputs are shown to accurately predict results is a model validated. This has never been done for FCC model.

14 The Commission has never established rules for determining how an entity which receives revenues from multiple sources and has multiple causes of cost can verify that it has expended one revenue source on one type of cost.

allocations which when added together constitute 100% of a carrier's regulated cost. Interstate costs left after subtracting out USF support are recovered pursuant to Part 69 rules, and intrastate costs are recovered through rules specified by the states.

If interstate cost is determined in part by embedded cost and in part by forward looking cost, it is certain that when added the total will be more or less (possibly much more or much less) than 100%. For non-rural companies, this is not an interstate problem, because their interstate rates are not cost-based or rate of return regulated. Most rural telephone companies, like SIC, are rate of return regulated. When all costs are determined consistently based on FCC rules, the USF recipient can unequivocally execute its Section 254(e) certification because it will be able to correlate its costs with support received.14 The added benefit is that when rates and support are tied to cost, a carrier's revenue streams will recover its revenue requirement and it will remain a financially viable business enterprise, positioned and encouraged (with some certainty in the regulatory regime) to continue to invest in rural America.

Retention of embedded cost for rural LECs will minimize the disruption inevitably resulting when a paradigm shift creates "winners and losers." The industry is currently in a state of extreme stress caused by potential changes in intercarrier compensation and the evolution of VOIP and other alternative technologies. At a minimum, there would be a substantial transition period for those companies with material reductions in support, but it is difficult to determine what that change should be or when the transition should begin until there is progress in the intercarrier compensation docket.

Further, given the proposals in the intercarrier compensation proceeding for major increases in USF support, the Joint Board should not now allow concerns regarding management of total fund size to lead to artificial restraints, such as caps, on the USF at this time. Further, the Joint Board should continue the “no barriers” approach that recognizes that in a rapidly evolving industry that is driven by technological advances, facilities constructed and operated necessary to provide supported services necessarily have capacity to provide multiple other non-supported services.

This very capacity for provision of multiple services in modern technology means that as services diversify and new revenue sources are developed, over time there will be less requirement for universal service support. The provisions in present rules that allocate costs and revenues first to unregulated services, and then to non-supported services should be maintained however costs are defined. These rules have the beneficial effect of allowing for reduction in need for support as eligible carriers evolve their services and increase the portion of their revenue received from other sources.

IIII RULES GOVERNING USF FOR TRANSFERRED EXCHANGES SHOULD BE REVISED

Section 54.305 was adopted by the FCC to curtail what it believed was the inflation of prices for properties sold by non-rural to rural companies.15 The FCC apparently believed these sales were motivated primarily by the additional USF support available to the latter. The reality is more complex however and the result is that subscribers suffered because the rule ignored the real world history of the rural telephone industry which has consistently shown that small companies actually care about their communities and want to provide improved and advanced services to the maximum extent possible.

The FCC reacted to the complaints that its rule discouraged investment in rural areas by adopting the "safety valve" provision in the *Rural Task Force Order.* Unfortunately, the safety valve fails to provide any meaningful assistance because in reality a new carrier taking over service responsibility must begin investment immediately in acquired exchanges. The rule, however, financially penalizes companies that do not wait a year to begin improvements. In addition, the limitation to half the support that would otherwise be available continues to restrict investment possibilities.

At a minimum, the Joint Board should recommend that the Commission distinguish between transactions that benefit the public and those simply churning property. The factors relevant to that question are typically addressed in state commission proceedings regarding transfer of control. The FCC rules should accept those findings where they are present, or conduct

15 *First Report and Order* at 8942-43.

similar inquiries in the bona fides of a transferor, but should not automatically and permanently penalize small rural companies that want to expand improved service to their neighbors through acquisitions from large carriers. History going back to the 19th century demonstrates the public benefits of encouraging small companies to serve rural areas. If the government is serious about the desire to move up from being number eleven in the world in broadband deployment, it should encourage sales from large companies to small rural companies, not vice versa as it does today.

V CONCLUSION

The Joint Board faces a formidable task in its undertaking to recommend new rules for Universal Service Support for rural telephone companies. Successful completion of this endeavor by the Joint Board is absolutely critical to fulfillment of the national objective of ensuring the availability of basic and advanced telecommunications services to "all the people of the United States," including rural, insular and high cost areas. 16 In Hawaii, one measure of success will be whether the residents of the Hawaiian Home Lands, areas that are rural, insular and high cost are able to obtain access to basic and advanced telecommunications and information services.

The Joint Board's task is complicated by the parallel proceedings at the FCC examining the broad subject of Intercarrier Compensation, of which universal service is a part. Because of this overlap and interdependence, Sandwich Isles Communications urges the Joint Board to proceed cautiously and not recommend rule changes with essentially unpredictable effects that may ultimately be incompatible with changes in access rules. The Joint Board's recommendations should also be designed to work in tandem with the programs of the Rural Utilities Service. Stabilization of a revenue stream that is "sufficient" to recover investments made in rural America should be the Joint Board's primary objective.

Respectfully submitted

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16 47 U.S.C. 151, 254.